

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

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Bill Number: AB 753

Related Bills: _____

Telephone: 845-3410

Introduced Date: 02/24/1999

Attorney: Doug Bramhall

Sponsor: Franchise
Tax Board

SUBJECT: Repeal Multistate Tax Compact

SUMMARY

Under the Revenue and Taxation Code, this bill would repeal the existing state law that adopted the Multistate Tax Compact (Compact), thereby allowing California to withdraw its membership in the Multistate Tax Commission (MTC).

EFFECTIVE DATE

This bill would be effective January 1, 2000.

PROGRAM HISTORY/BACKGROUND

The concept of the Compact originated with the predecessor to the current Federation of Tax Administrators, the National Association of Attorneys General, and the National Conference of State Legislators. The Compact and its administrative body the MTC originally were formed to provide an organization for collective action on tax matters by the states.

The Compact became operative in 1967 with its adoption by seven states. California became a member effective January 1, 1976.

The MTC facilitates proper determination of state tax liabilities; promotes uniformity and compatibility in state tax systems through such efforts as model regulations, statutes, and guidelines; facilitates taxpayer convenience and compliance; and works toward avoidance of duplicative taxation. In addition, the MTC provides special programs on contracted bases, such as the nexus and audit programs. In the income tax area, the Uniform Division of Income for Tax Purposes (UDITPA) was adopted as the primary charter.

Twenty-one states are Compact Members: Alabama, Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Maine, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah and Washington. Sovereignty Member is Florida. In addition, there are 17 Associate Members and four Project Members. The rights and privileges of these membership classes are:

Compact Member: Pays membership dues and has full voting rights in the MTC and its various committees. Receives special contracted program services at cost.

Board Position:

<u>X</u>	<u>S</u>	<u> </u>	<u>NA</u>	<u> </u>	<u>NP</u>
<u> </u>	<u>SA</u>	<u> </u>	<u>O</u>	<u> </u>	<u>NAR</u>
<u> </u>	<u>N</u>	<u> </u>	<u>OUA</u>	<u> </u>	<u>PENDING</u>

Department Director

Date

Gerald Goldberg

3/31/1999

Sovereignty Member: Pays membership dues and receives special contracted program services at cost, but has not adopted the Compact and, thus, cannot vote in MTC proceedings. However, a Sovereignty Member can participate and vote in various committees, such as uniformity, and can participate or lead task forces.

Associate Member: Eligible to participate in all MTC special contracted programs and committees. Has no vote. Pays the costs of the special contracted programs in which it participates plus a 15% surcharge for administrative costs.

Project Member: Participates only in special contracted programs. Has no vote. Pays the cost of the special contracted programs in which it participates plus a 15% surcharge for administrative costs.

The voting process in MTC is two-fold. For each issue voted upon, each voting member gets one vote and each member gets weighted votes based on the population in the member state. For an issue to pass, it must pass by a majority of both vote measurements.

The Franchise Tax Board (FTB) has taken various steps to reduce the department's participation in the MTC programs:

- In 1989, the FTB significantly reduced participation in MTC audit services.
- In September 1996, the FTB resolved to notify the MTC not to include it in any Nexus Program Bulletin.
- In October 1996, the FTB prompted the MTC to amend its public participation policy to basically incorporate a portion of the Bagley-Keene Open Meeting Act.
- Finally, on February 4, 1998, the FTB directed department staff to send a letter to the MTC to terminate the department's contract for the remaining audit and nexus program services and to notify the MTC of the FTB's belief that all MTC services should be provided to member states in return for the membership fee and that all non-member states bear the full cost of services provided to them by the MTC.

The Members of the Board of Equalization (BOE), in 1997, voted to continue to pay MTC membership dues but to withdraw from participation in the MTC nexus program. However, because the MTC decided to waive for two years California's fees for the nexus program, both the BOE and FTB resumed some participation in that program.

SPECIFIC FINDINGS

Under existing law, California has adopted the Compact and is a voting Compact Member of the MTC. The focus of MTC is taxation of multistate and/or multinational corporations. The scope of the MTC includes corporate income taxes, franchise taxes, sales and use taxes, and property taxes. MTC engages in the following activities:

- Litigation and legal support activities.
- Lobbying activities in Washington D.C.
- Promotion of uniform tax laws, regulations, and practices in states.
- Specific programs and activities that address emerging tax issues.
- Operation of a joint audit program that provides for a single audit covering tax obligations of several states.

The Compact provides for allocation of MTC's budget one-tenth in equal shares and nine-tenths in proportion to the tax revenues collected by the MTC members. This formula applies to the general administrative budget of the MTC. Currently, California pays approximately \$400,000 in annual dues to the MTC, which amounts to roughly 30% of the entire administrative MTC budget.

Specific additional program services, such as audit, nexus, and dispute resolution, are provided by contract between the MTC and contracting states. For example, a state only participates in the MTC budget for audit services to the extent that state has the MTC perform audits for it. California significantly reduced participation in MTC audit services in 1989 and currently participates only in the nexus program.

According to Attorney General Opinion No. 96-806, "[t]he only way for California to withdraw from Commission membership would be for the Legislature to repeal the statute enacting the Compact. No provision of the Compact allows for a state to withdraw from the Commission separate and apart from withdrawing from the Compact. The latter must be accomplished by the enactment of a state statute repealing the Compact." Further, "California remains liable for its Multistate Tax Commission assessments chargeable to it prior to the time of its withdrawal from the Multistate Tax Compact."

The justification for California entering into the MTC essentially was that MTC was able to provide various programs and features that California could not accomplish on its own at that time. However, the department determined that California's interests could be better served through its own out-of-state programs. For instance, MTC collective audits have tended to not be accomplished with the same high standards that California requires for its own audits. As a result, with regard to franchise and income tax matters, California has ceased participation in the MTC special audit program, which is the program from which most of the revenue gains associated with FTB activities had been realized. Although California's interests could be better served by its own programs that mirror those provided by MTC, the amount that California pays in annual membership dues to the MTC is significant.

This bill would withdraw California's membership in the MTC by repealing the existing state law that created the multistate compact.

Repeal of the Multistate Tax Compact would withdraw the memberships of both of the state's tax agencies, the FTB and BOE. However, both organizations still would be able to engage on a contractual basis in any of the MTC special programs, such as the nexus program.

Policy Considerations

California continues to expend nearly \$400,000 (approximately \$200,000 each for the FTB and the BOE) annually in MTC dues but no longer receives as much benefit from the payment of those dues because its interests would be better served by its own out-of-state audit programs. By withdrawing from the MTC, the state would save significant amounts of money annually and should not experience any significant form of revenue loss.

To the extent that California is involved in the special nexus program provided by MTC, withdrawal of the state's MTC membership would not affect that involvement, since all the MTC's special programs are open equally to members and nonmembers. However, withdrawal from MTC membership would forfeit the two year waiver of nexus program fees and 15% surcharge for administrative costs.

Withdrawal from MTC would eliminate California's ability to influence the substance of MTC recommendations.

Although withdrawal from the MTC would remove California's right to vote on MTC issues, once MTC makes recommendations on those issues, California still could choose whether to adopt those recommendations for its own purposes.

Implementation Consideration

Implementing this bill would not significantly affect the department's administration of its programs and operations.

Fiscal Impact

Departmental Costs

Repeal of the Multistate Tax Compact and corresponding withdrawal as a general member of the MTC would result in savings from cessation of member dues in the approximate amount of \$400,000.

Tax Revenue Estimate

Assuming the state continues to participate in the MTC nexus program, there are no identified significant revenue impacts from discontinuing membership in the MTC.

BOARD POSITION

Support.

At its December 16, 1998, meeting, the Franchise Tax Board voted 2-0 to sponsor this bill.